



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
COMMERCIAL SECURITIES CORPORATION, CONS.)

Appearances:

For Appellant; Thomas & Moore, Certified Public Accountant

For Respondent: Chas. J. McColgan, Franchise Tax Commission

O P I N I O N

This is an appeal pursuant to Section 25 of the Rank and Corporation Franchise Tax Act (Chapter 13, Stats. 1929, as amended) from the action of the Franchise Tax Commissioner in overruling the protest of Commercial Securities Corporation, Cons. to a proposed assessment of an additional tax in the amount of **\$3,076.31** for the calendar year 1931 based upon its return for the year ended December 31, 1930.

It appears that during the year 1927 a thorough audit was made of the records of the corporation which disclosed many irregularities on the part of the former officers and directors of the corporation; These irregularities consisted of misuse of corporate funds, illegal distribution of **dividends**, embezzlement of property, etc. As a result of these irregularities it is contended that the corporation had prior to January 1, 1928 valid claims **against** its former officers and directors **totalling** approximately **\$400,000.00**. Early in the year of 1928, suits were filed against the former officers and directors, one of which was brought to trial and judgment entered for the corporation in the year 1930 for **\$149,519.13** and **5022** shares of stock of the Leslie California Salt Company. The amount of the money judgment was made up of **\$97,294.80** for **recovery** of stolen property and **\$52,224.33** for interest. After entry of the judgment, all of the claims against the former officers and directors were settled for a total consideration of **\$162,748.00** out of which legal fees aggregating **\$40,764.00** and **other costs amounting to \$10,403.92** were paid, leaving a net **collection** by the corporation of **\$111,580.08**. The issue involved in this appeal is whether the amount collected or any portion of the amount collected constitutes income of the corporation for the year 1930.

It seems clear that insofar as the amount collected represents a reimbursement to it for property stolen from it or for dividends irregularly distributed, the amount collected cannot be regarded as income for the year 1930. On the other hand it may be argued, in view of the fact that of **the** judgment entered in 1930, **\$52,224.33** was designated as interest, a

Appeal of Commercial Securities Corporation, Cons.

portion of the total amount collected in settlement of the **claim** should be regarded as interest and therefore as income for the year 1930.

However, it is to be noted that the corporation contends that it had claims against its former officers and directors prior to January 1, 1928 totalling approximately \$400,000.00 and that it collected on these claims only \$162,748.00. If the corporation had valid claims in the amount of \$400,000.00 or, for that matter, if it had valid claims arising prior to January 1, 1928 on account of illegal distribution of dividends, or on account of property stolen from it, in any amount in excess of the amount collected, the full amount collected would have to be regarded as reimbursement to the **corporation** on account of property **stolen from** it or on account of dividends irregularly distributed and thus no portion of the amount collected could be regarded as income for the year 1930.

But even if the valid claims amounted to less than the amount collected, and the difference should be regarded as interest and **therefor** as income, a considerable portion of the interest would be attributable to the years prior to January 1, 1928 and **therefor** should not be included in the measure of the tax imposed by the Act even though received after January 1, 1928. (See Institute of Musical Education, decided by this Board April 21, 1932, in which we held that under the Act as it read in 1931 - the year for which the assessment in question was proposed - it was not intended that gains or income accrued prior to January 1, 1928 should be considered in computing franchise tax imposed by the Act even though received after January 1, 1928).

Finally, it will be noted that the deductible expenses incurred in obtaining **the** settlement of the claims amounted to **well** over \$50,000.00, a sum in excess of that portion of the amount collected which could possibly be regarded as income for the year 1930. Consequently, even if some portion of the amount collected were regarded as income for the year 1930, there would still be no net income by which the proposed **addi-**tional assessment could be measured.

For the above reasons, we are of the opinion that the action of the Franchise Tax Commissioner in overruling the protest of the Appellant to the proposed assessment in question must be reversed.

W R W E R

Pursuant to the views expressed in the opinion of the Board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED. ADJUDGED AND DECREED. **that the action** of Chas. J. **McColgan**, Franchise Tax Commissioner, in overruling the protest of Commercial Securities Corporation, Cons. against a proposed additional assessment in the amount of \$3,076.31 based

Appeal of Commercial Securities Corporation, Cons.

upon the return of said corporation for the year ended December 31, 1930, under Chapter 13, Statutes of 1929, as amended, be and the same is hereby reversed. Said ruling is hereby set aside and said Commissioner is hereby directed to proceed in conformity with this order.

Done at Sacramento, California, this 30th day of January, 1934, by the State Board of Equalization.

R. E. Collins, Chairman
Jno. C. Corbett, Member
H. G. Cattell, Member

ATTEST: Dixwell I., Pierce, Secretary